In the Supreme Court of the United States

OCTOBER TERM, 1941.

No. . . . . .

In the Matter of
VAN SWERINGEN CORPORATION,
Debtor.

THE TERMINAL AND SHAKER HEIGHTS
REALTY COMPANY
(formerly Midamerica Corporation),
Petitioner,

vs.

VAN SWERINGEN CORPORATION, *Debtor,*
and
FREDERICK L. LECKIE and JOSEPH G. FOGG,
Trustees of Van Sweringen Corporation,
Respondents.

BRIEF OF PETITIONER
In Support of Petition for a Writ of Certiorari.

In support of its petition for a writ of certiorari in this case, Midamerica files herein its brief and relies upon the reasons listed in its petition as more fully set forth below.

REASONS FOR GRANTING THE WRIT.

1. The Decision Below is in Conflict with a Decision of the Circuit Court of Appeals for the Second Circuit on a Matter of Importance in the Administration of the Bankruptcy Act.

In *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2, 1936) cert. den. under the name of *Brukenfeld et al. v. New York Railways Corporation et al.*, 298

U. S. 687 (1936) the question was the enforceability in full by the Fifth Avenue Coach Company of bonds of its subsidiary-debtor, the New York Railways Corporation, then in reorganization under Section 77B. Holding 100% of the common stock and having exclusive voting rights, the parent was a fiduciary. *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919). The parent, prior to the 77B proceedings, had purchased $11,000,000, or 54%, of its subsidiary's income bonds at 10% of their face value, and objection was made to the allowance of the parent's claim on these bonds for more than their cost to it. The court held that, because a majority of the debtor's board were "independent" and owed no "allegiance" to the parent, the debtor's failure to acquire its bonds for itself was not owing to improper influence. The parent had not "actively prevented" the purchase of these bonds by the debtor, and hence the court said:

> "The failure of the debtor to so act was undoubtedly due to its financial inability rather than to any other fiduciary faithlessness." (p. 741 of 82 Fed. (2d)).

Here, as in the *New York Railways* case, the failure of the Debtor to acquire its notes was undoubtedly due to its financial inability rather than to fiduciary faithlessness. This is so for two reasons:

(a) Midamerica did not buy the Debtor's notes for $887. Midamerica bought 28 parcels of securities in Group 1 for $2,803,000, by a group bid. (R. 31.) In Appendix A hereof appears a tabulation of these 28 parcels as listed in J. P. Morgan & Co.'s notice of sale. On the day of the sale no consideration was, or had been, allocated to the Debtor's notes or to the other twelve parcels within Group 1 for which no individual bids were made. Midamerica's subsequent allocation—for accounting purposes—of $1.00 to each of these parcels (except for the arbitrary allocation of $887 to the Debtor's notes) does not establish that

Midamerica could have bought, or did buy, these parcels individually for $1.00 or the Debtor's notes for $887.

(b) Even if Midamerica's group purchase is interpreted as meaning that Midamerica purchased the Debtor's notes for $887, neither the record nor sound business judgment warrants the inference that J. P. Morgan & Co. would have sold the Debtor's notes as a separate parcel for $887, or, if so, that such a sale would have been made to this Debtor. The qualifying deposit for parcel 24 was $250. The public auction itself was conducted at arms' length, and the Court below, in related litigation involving the validity of J. P. Morgan & Co.'s loan to C. T. B., *Gochenour v. J. P. Morgan & Co.*, 111 Fed. (2d) 378 (C. C. A. 6, 1940), found the sale to be fair and free from collusion. Nor is there evidence to justify the belief that any antecedent plan by the Debtor in advance of the auction to retire $13,787,000 of valid indebtedness by bidding a nominal sum would have been reasonable or practicable.

Yet the Debtor has consistently argued—and the two lower courts apparently believed—(i) that because this insolvent Debtor had $13.67 in cash available and a large unsecured claim against its utterly insolvent subsidiary, C. T. B., therefore, it could have acquired $13,787,000 of its notes by bidding $887, and (ii) that the Van Sweringens were guilty of gross dereliction in not foreseeing and acting upon this possibility on the Debtor's behalf. It is respectfully urged that this argument ignores realities.

The truth is that here as in *In re New York Railways Corporation, supra,* the failure of the Debtor to act was undoubtedly due to its financial inability and not to prevention by the Van Sweringens or anyone else of a plan by the Debtor to purchase for itself.

It may be contended that the cases are distinguishable in one respect: i.e., the Van Sweringens undoubtedly controlled the Debtor, whereas the court said in the *New York*

Railways case that the board of the subsidiary company was independent and that there was no ground to infer from its inaction any improper influence by the parent.* This distinction is more apparent than real.

As appears from the opinion, the "independence" of the New York Railway board consisted of the fact (see p. 741 of 82 Fed. (2)) that after a period of admitted domination through interlocking directors, the board was reshuffled shortly before the parent's buying program began—so that thereafter only a minority of the board was interlocking. But it is plain from the course of events that in every practical sense, the parent, with 100% voting rights, controlled its subsidiary.**

Thus the parent's plan for acquisition of the bonds was wholly inconsistent with their acquisition by the subsidiary. The parent knew that its stock investment in the subsidiary was of doubtful value, that reorganization was imminent, and that its continued control was threatened unless it could acquire a majority of the subsidiary's income bonds (p. 741, *ibid*). Yet the court held that its action was entirely proper.

It follows, therefore, that in the Second Circuit a dominant stockholder, who is unquestionably a fiduciary, but who sees its investment and control threatened, may purchase at a discount a majority of its subsidiary-debtor's bonds of a given issue and may thus protect its position

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* *In re New York Railways Corporation* was distinguished by the District Court below on this ground. (R. 271.)

** The identical board, as reconstituted in April, was retained in office by the parent at its annual meeting one month later, and the same board continued in office thereafter for two more years. See Petition for Certiorari, page 12, in the United States Supreme Court, October term 1935, No. 1050, filed by Carl Brukenfeld, Louis Krones and Philip Kerby, as a preferred stockholders committee; see also record in that case 1234, 1236, 1251, 1375, and 1236.

by enforcing the bonds in full in subsequent 77B proceedings; provided only that the debtor itself lacks funds for such purchase and that the fiduciary does not "actively prevent" the debtor's purchase on its own behalf. In the Sixth Circuit, on the other hand, dominant directors, under strikingly similar circumstances, must hold what they buy in constructive trust for the debtor.

Nor does this divergence between the two circuits concern a question of infrequent occurrence or slight significance in the administration and interpretation of the Bankruptcy Act.

(i) In no less than eleven cases* arising under former Section 77B or present Chapter X of the Bankruptcy Act, the enforceability of a claim has been attacked on the ground that the acquisition of such claim involved a violation of fiduciary duty or kindred inequitable conduct.

These cases do not present fraud, as in *Pepper v. Litton*, 308 U. S. 295 (1939), nor direct dealings by an officer or director with his company as in *Pepper v. Litton*. They are concerned with purchases of claims against the debtor company by officers or directors who acquire such claims from third persons.

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* *In re McCrory Stores Corporation*, 12 Fed. Supp. 267 (1935); *In re New York Railways Corporation*, 82 Fed. (2d) 739 (C. C. A. 2), cert. den. 298 U. S. 687 (1936); *In re Celotex Co.*, 12 Fed. Supp. 1 (1935); *Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Company, et al.*, 85 Fed. (2d) 557 (C. C. A. 9, 1936); *In re McEwen's Laundry Inc.*, 90 Fed. (2d) 872 (C. C. A. 6, 1937); *In re Radio-Keith-Orpheum Corp.*, 106 Fed. (2d) 22 (C. C. A. 2, 1939); *In re Utilities Power & Light Corp.*, 29 Fed. Supp. 763 (1939); *In re Norcor Manufacturing Company*, 109 Fed. (2d) 407 (C. C. A. 7), cert. den. 310 U. S. 625 (1940); *The Terminal and Shaker Heights Realty Company v. The Van Sweringen Company, The Terminal and Shaker Heights Realty Company v. The Van Sweringen Corporation, The Terminal and Shaker Heights Realty Company v. The Cleveland Terminals Building Company*, all reported in 119 Fed. (2d) 231 (C. C. A. 6, 1941).

Except for claims of landlords, in respect of which this Court has now laid down definitive rules,* the claims of fiduciaries, as shown by the history of Section 77B and Chapter X proceedings, have caused most confusion and uncertainty. Moreover, since investment by corporate officers and directors in the securities of their companies is a widespread and generally understood business practice, the lower federal courts will be increasingly confronted with litigation until definitive rules in this field also have been prescribed by this Court.

(ii) In several of these so-called "fiduciary" cases the lower courts have correctly felt called upon to determine the proper interpretation, scope and effect of two sections of the Bankruptcy Act closely related to the question in this case. Section 202 (U. S. C. A. Title 11, Section 602) provides in material part that the court shall scrutinize the circumstances of an assignment of a future rent claim and the amount of the consideration paid for such assignment in determining the amount of damages allowed the assignee thereof. Section 212 (U. S. C. A. Title 11, Section 612) provides in material part that, in the case of any agent or committee purporting to represent creditors or stockholders, the court may limit any claims or stock acquired by such agent or committee in contemplation or in the course of a proceeding under Chapter X to the actual consideration paid therefor.

One or the other of these sections (set forth in Appendix B hereof) or their predecessors in Section 77B were the subject of careful consideration in four of the cases above noted, i.e., *In re McCrory Stores Corporation, In re*

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* *Kuehner, et al., Trustees, v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 445 (1937); *City Bank Farmers Trust Co., Assignee v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 433 (1937); *Meadows v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 464 (1937); *Schwartz, et al. v. Irving Trust Co., Trustee in Bankruptcy, et al.*, 299 U. S. 456 (1937).

McEwen's Laundry, Inc., Security-First National Bank of Los Angeles, et al. v. Rindge Land & Navigation Co., and *In re Celotex Co.*, all *supra*.

The reason for this is plain: Section 212 is a legislative declaration that where claims or stock are acquired by an agent or committee in a representative capacity under circumstances which may involve breach of fiduciary duty, the claimant shall not enforce the claim or stock for more than its cost to him. Section 202 relates to assignment of landlords' claims under circumstances which, as a practical matter, are apt to involve a breach of fiduciary duty. See *In re McCrory Stores Corporation, supra*, the earliest and most frequently cited case in this field.

Consequently, the interpretation and correct application of these two specific provisions of the Bankruptcy Act will in all probability be influenced by the decision of this case.

(iii) It follows from (i) and (ii) above that the present question—although it probes deeply into the law of corporate fiduciaries—is not merely a question of state or local law. Midamerica recognizes that under the decision in *Ruhlin v. New York Life Insurance Co.*, 304 U. S. 202 (1938), conflict among the circuits on the same matter "is not of itself a reason for granting a writ of certiorari" (p. 206, *ibid*) because, since *Erie Railroad Co. v. Tompkins*, 304 U. S. 64 (1938), such conflict "may be merely corollary to a permissible difference of opinion in the state courts." (p. 206 of 304 U. S.)

In the present instance, however, the conflict does not concern a purely local matter like the construction of an insurance contract as in the *Ruhlin* case, *supra*, but on the contrary strikes to the heart of the administration of a national law. The purpose and effect of the Federal reorganization statutes in supplanting equity receiverships is familiar history, *Continental Illinois National Bank &*

Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., 294 U. S. 648, 672 (1935); and the result is that the Federal courts, sitting in bankruptcy and reorganization proceedings, are the forum in which the validity of discount purchases of claims by corporate officers and directors is today tested with the greatest frequency. The volume of litigation in the Federal courts on the subject of discount purchases by fiduciaries has previously been noted (p. 15, *supra*). In two specific sections of the Bankruptcy Act, Sections 212 and 202, dealing with analogous situations, Congress has itself legislated on this subject. Thus, for example, if the present case had been one arising under Section 212 and the Debtor, by favor of that specific section, had set up precisely the same defense as here, the "construction and validity" of a provision of the Bankruptcy Act would in all probability have been squarely involved.*

The Federal Constitution (Article 1, § 8, Cl. 4) vests Congress with the power "to establish * * * uniform Laws on the subject of Bankruptcies throughout the United States." This Court, in varying factual situations, has expressly recognized the desirability of adhering to a policy of uniformity so far as possible. In *Kreitlein v. Ferger*, 238 U. S. 21 (1915) the Court (in considering an objection to a sufficient listing of a creditor's name) said:

> "* * * This objection is more difficult of solution than any of the others presented by this record. But, like them, it must be considered in the light of the fact that the statute was intended for business men and should receive not only a practical but a uniform construction. Its provisions are applicable to creditors who live in the country, in villages, in towns and cities. * * * " (p. 30 of 238 U. S.)

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* (Cf. the group of decisions of this Court cited in the footnote on p. 16, involving the "construction and validity" of the sections dealing with landlords' claims.)

Cf. *Local Loan Co. v. Hunt,* 292 U. S. 234, at page 245 (1934).

This view has been echoed in the lower federal courts. In *In re Bockhaus,* 177 Fed. 141, C. C. A. 7 (1910), the court, pointing out that the Bankruptcy Act is "a national act" and was intended to eliminate as far as possible "the confusion and harassment attendant upon a multiplicity of variant local laws" used the following language:

> "* * * Therefore the act in all its parts ought to be interpreted in a national view, doing away as far as possible with the variances of the local laws. * * *" (p. 145, *ibid.*)

Midamerica submits that the foregoing interpretation of the act is sound and not in derogation of *Erie Railroad Co. v. Tompkins* and that the concept of state law under the doctrine of *Erie Railroad Co. v. Tompkins* should not be expanded in doubtful cases in such a way as to produce unnecessary confusion in the administration of a national act.

Midamerica points out, moreover, that such confusion, produced by the absence of clear principles of guidance, may frequently have the result in the various circuits—as was the fact here—of seriously delaying corporate reorganizations. Such a result is contrary to the intent of Congress that reorganizations be facilitated as much as possible. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co. et al., supra,* at p. 685. Midamerica, therefore, urges that certiorari should here be granted to secure uniformity of decision in a field where uniformity is clearly desirable. *Magnum Import Co. v. Coty,* 262 U. S. 159 (1923).

2. If the Conflict with the Circuit Court of Appeals for the Second Circuit Relates to a Question Which is Controlled by State Law, the Decision Below is Probably Untenable and is in Conflict with the State Law.

If, despite the considerations outlined under subsections (i), (ii) and (iii) above, this Court should conclude that the conflict relates to a question controlled by state law, Midamerica submits, in the alternative, that certiorari should be granted because the decision below is "probably untenable" and "probably in conflict with the state law." (See language of Mr. Justice Reed at p. 206 of *Ruhlin v. New York Life Insurance Co., supra.*)

On the assumption that state law governs, it is clear that, under settled principles of the conflict of laws, the applicable law is either that of New York or of Delaware. New York is the state where the Morgan auction sale was held and where the Van Sweringens acted, or failed to act, in such a way as allegedly to involve themselves in a breach of fiduciary duty to the Debtor. See *Beale, The Conflict of Laws,* Vol. Two, §§ 377.2, 378.1 *et seq.* Delaware is the state of the Debtor's incorporation. See *Rogers v. Guaranty Trust Company of New York,* 288 U. S. 123 (1933).

If the law of New York governs, the decision below was in conflict with that law as announced in *Tiffany v. Smith,* 124 N. Y. Sup. 85 (1910), being the only New York case on the subject. In *Tiffany v. Smith,* which was strongly relied on by petitioner below, directors who had guaranteed the obligations of their company were permitted to protect themselves upon a judicial sale of the company's property by buying in the property for themselves, even though they had not discharged their guaranty.

If the law of Delaware governs, we are remitted to the entire body of substantive law on the question, for there is no relevant Delaware authority. There are, of course, general statements in Delaware cases regarding the duty of a director to his corporation (e.g. *Cahall v. Burbage,*

13 Del. Ch. 299, 119 A. 574 (1922)), but opposing counsel have not cited—and petitioner has been unable to find—any Delaware case in point on the issue here involved. Midamerica believes, however, that the decision below was probably in conflict with the Delaware law "as yet unannounced by the highest court of the state" (p. 206 of *Ruhlin v. New York Life Insurance Co., supra*), because that decision was so clearly opposed to the weight of authority.

Relevant decisions of this Court and of the lower federal courts plainly establish the right of a director to protect legitimately acquired interests and to avoid the personal loss and individual liability which would result from the denial of such right in cases where the director has advanced cash or lent credit to his company. These decisions are *Twin-Lick Oil Co. v. Marbury,* 91 U. S. 587 (1875); *Sanford Fork & Tool Co. v. Howe, Brown & Co.,* 157 U. S. 312 (1895); and *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), all of which are analyzed fully under Reasons 3 and 4 below and which, therefore, in the interest of brevity are not discussed at length at this point.

3. The Decision Below Fails to Follow Applicable Decisions of this Court and of the Circuit Court of Appeals for the Fifth Circuit on an Important Question in the Law of Corporate Fiduciaries.

In *Twin-Lick Oil Company v. Marbury,* 91 U. S. 587 (1875), a director in good faith lent money to his corporation and took a mortgage on certain of its property to secure the loan. On default, he foreclosed the mortgage and bought in the property himself. This Court held that he was not accountable for profits later derived from this property; and since this decision, it has been settled law that a director of a corporation may in good faith lend money to it and that the debt thereby created and the security given therefor are valid and enforceable in his hands.

The Court started from the premise that the loan itself was proper. It then reasoned as follows: (i) Since the loan was valid, the director could properly take security. (ii) Since he could take the security, he had a right to enforce it. The case thus stands for the obviously fair doctrine that where a director, acting throughout in entire good faith, acquires valid rights against his company, he may take appropriate steps to protect those rights, and his action in so doing is not inconsistent with his duty of loyalty. Midamerica invokes this doctrine here.

Through personally guaranteeing the $16,000,000 Morgan loan to Vaness in 1930, the Van Sweringens in good faith lent their credit to Vaness. Vaness was a parent holding company which owned 71% of the Debtor's stock and which, pursuant to an offer to all known noteholders of the Debtor, had purchased from the public $13,787,000 of the Debtor's notes for approximately $7,000,000 in cash and 275,000 shares of the Debtor's stock. (R. 48-50, 53, 27.) Because of this guaranty, the Van Sweringens not only risked the complete loss of their investment in Vaness (to which they had made a capital contribution of nearly $15,000,000 (R. 153-155, 176) and 80% of whose common stock they owned (R. 24)), but also they pledged their personal resources to the extent of any deficiency which might result on foreclosure of the Morgan loan of $16,000,000 to Vaness.*

From the beginning, therefore, the Van Sweringens as guarantors were profoundly concerned with the aggregate value of all the pledged collateral. Their contingent liability rose and fell as its value fluctuated up and down, and finally became fixed when its value became fixed on the day

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* Vaness had also guaranteed the $23,500,000 Morgan loan to C. T. B., and consequently all the assets of Vaness, as well as all the personal credit of the Van Sweringens, were back of both loans. (C. T. B. record, pp. 124, 243.)

of the public auction on September 30, 1935. The Van Sweringens' economic and equitable interest in the collateral was thus obvious and unquestioned and justified their attempt to minimize probable heavy loss by acquiring some share in it.

Their attempt, of course, failed. The Van Sweringens at the time of the auction were hopelessly insolvent, with relatively small assets and with liabilities (arising mainly from guaranties of debts of their companies) which totalled more than $50,000,000. (R. 166.) M. J. Van Sweringen died within two months, owing $68,000,000. (R. 166-167.) O. P. Van Sweringen died within a year and two months, owing $80,000,000. (R. 167.) They had not, and could not have, exercised the option. But the very hopelessness of their endeavors to save themselves from total ruin shows how plainly the court below disregarded the record in concluding that the Van Sweringens somehow made a profit from Midamerica.

Until the Van Sweringens had discharged their guaranties, they could make no profit from Midamerica and, indeed, they had no reasonable possibility of making such a profit at any time. Certainly they made no profit from their option, which was never exercised because it could only be exercised after the payment or adjustment of all their debts, including their guaranties. Certainly they made no profit from a drawing account which was given as compensation for management of the valuable railroad properties, which has never been attacked as unreasonable, and which would have been precisely the same irrespective of Midamerica's acquisition of the Debtor's notes. Consequently, *Magruder v. Drury*, 235 U. S. 106 (1914), and *Jackson v. Smith*, 254 U. S. 586 (1921), holding that a fiduciary and his associates are liable for profits realized from their dealings with the beneficiary, are irrelevant, and the reliance of the court below on these cases was error.

The court below dismissed the entire foregoing argument in one paragraph, citing an Ohio case which did not even involve a guaranty.

> "From the premise that the *Twin-Lick Oil Company* case, *supra*, establishes the right of a director to protect a validly acquired interest as against his corporation, appellant earnestly insists that it should prevail in these suits. We cannot concur. The mere fact that the Van Sweringens were endorsers and guarantors of heavy obligations of the corporations in which they were directors does not avoid the effect of the doctrine that they should not be permitted, directly or indirectly, to derive from their position personal profit or advantage not shared by all stockholders. See *Thomas v. Matthews*, 94 O. S. 32, 43."

Twin-Lick Oil Company v. Marbury, supra, clearly demonstrates the incorrectness of this view, because the very basis of this decision is that a director who has lent his credit to his company acquires by virtue of that fact important contract and property rights which otherwise he would not possess. *Twin-Lick Oil Company v. Marbury* was cited with approval in *Allen v. Gillette,* 127 U. S. 589 (1888), and in *Starkweather v. Jenner,* 216 U. S. 524 (1910), to sustain the proposition that even an express trustee may purchase trust property at a judicial sale which he has taken no part in procuring and over which he had no control.

Moreover, the Circuit Court of Appeals for the Fifth Circuit in a recent decision relies in part upon the doctrine of *Twin-Lick Oil Company v. Marbury* to sustain a purchase of corporate property against the charge of breach of fiduciary duty. The case is *Arn v. Bradshaw Oil & Gas Co.,* 108 Fed. (2d) 125 (1940), cert. den., 310 U. S. 646. Here a bank holding a first mortgage given by an oil company foreclosed the mortgage and bid in the property at judicial sale. A few days later, by a separate and independent transaction, it resold the property to the Brad-

shaw Company, which had been formed for this purpose by a group of second-lien creditors of the oil company. Bradshaw, who was president of the new company, had been a director of the oil company and had formerly been associated with one of the largest second-lien creditors. Boyd, who owned a stock interest in the new company, had also been a director of the oil company and continued to be associated with another second-lien creditor. Stockholders of the oil company contended that the position of Bradshaw and Boyd resulted in a violation of their fiduciary duty to the oil company.

The court held to the contrary, citing as one of three relevant decisions by this Court, *Twin-Lick Oil Company v. Marbury, supra.** Among the facts emphasized in the opinion are three in which the *Arn* case closely resembles the case at bar: (a) all the directors of the oil company "did their best" for the oil company prior to the sale (p. 127 of 108 Fed. (2d)); (b) none of the directors of the oil company brought about the foreclosure sale or contributed to it (p. 127, *ibid*); (c) the purchase by the second-lien creditors in order "to recover if possible" their debts against the oil company was not an abuse by the directors of their office (p. 128, *ibid*).

Thus *Twin-Lick Oil Company v. Marbury,* as interpreted by later decisions of this Court and by at least one Circuit Court of Appeals, stands for the principle (in no way inconsistent with a director's duty of loyalty to his corporation) that a director may protect validly acquired rights. Unless this principle is to be narrowly confined to the simple case of a cash loan and sternly rejected in the case of a credit loan, it should govern here.

If the Van Sweringens had been financially able to pay the loan to Vaness and so discharge their guaranty, they

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* The other two cases cited are *Michaud v. Girod,* 4 How. 503 (1845) and *Stephen v. Beall,* 22 Wall. 329 (1874).

would have acquired indefeasible rights in the pledged collateral.* In equity the Van Sweringens, because they continued to remain liable on their guaranties, stand in the same position *with respect to this Debtor* (which could not have received any part of such payment) as if they had paid the loan.

As this Court said in the *Twin-Lick Oil Company* case:

> "Defendant was at liberty to bid, subject to those rules of fairness which we have already conceded to belong to his peculiar position; for, if he could not bid, he would have been deprived of the only means which his contract gave him of making his debt out of the security on which he had loaned his money." (pp. 590-591 of 91 U. S.)

So here, to deny the Van Sweringens the right to buy the Debtor's notes at a free, open and public sale would be to deprive them of their only means of reducing their deficiency liability as guarantors and would nullify in large measure the right of a guarantor or surety to look for protection to the collateral pledged by the principal obligor.

4. The Decision Below, by an Overzealous Application of Pepper v. Litton, 308 U. S. 295, Ignores Well-Settled Principles of Equity as Declared by this Court and, in Fact, Undermines a Director's Duty of Loyalty.

Although the evident purpose of the opinion below is to enforce vigorously a director's duty of loyalty to his corporation in accordance with the recent enunciation of this well-settled duty in *Pepper v. Litton, supra,* the effect of the opinion will be precisely the opposite. The decision, if allowed to stand, will tend to have a widespread, undesirable influence on the attitude of corporate directors because of the very extremes to which it goes and because

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* *Leavenworth County Comm'rs v. C. R. I. & P. Ry.*, 134 U. S. 688 (1890); *Sanford Fork & Tool Company v. Howe, Brown & Company*, 157 U. S. 312 (1895); *Fitzgerald and Mallory Construction Co. v. Fitzgerald*, 137 U. S. 98 (1890).

of the changed judicial attitude which it evidences toward directors who have pledged their entire personal resources for their corporation.

In *Sanford Fork & Tool Company v. Howe, Brown & Company,* 157 U. S. 312 (1895)* this Court clearly confirmed the right of a director-guarantor to protect himself against loss upon his guaranty. In that case the Court had under consideration the validity of a mortgage given by a corporation while insolvent, although still a going concern, in order to protect its directors from liability on account of their personal guaranty of the corporation's notes. In the course of its opinion this Court made the following observation, which is especially pertinent to the circumstances under which the Van Sweringens executed the guaranties here involved:

> "* * * The mortgage was not given simply as security for a past indebtedness, but to induce the indorsers to obtain for the corporation a renewal or extension of its obligations, and to make further indorsements. In reliance upon this mortgage the indorsers secured renewals or extensions, or themselves took up the notes they had indorsed, and at the same time lent the credit of their names to new paper of the company. *Thus they prevented a suspension of the business and enabled the corporation to continue its operations, and did so believing that by such continuance the corporation would be enabled to work itself out of its temporary difficulties. All this was done in the utmost good faith.*" (pp. 316, 317 of 157 U. S.)
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> "We are of opinion that these facts clearly and fully distinguish this case from many which have been

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* The *Sanford* case was cited to the court below as one of 16 decisions (collected in the appendix to Midamerica's main brief below) which involved guaranties by a fiduciary and in which the fiduciary's purchase of corporate property or debt was upheld. The *Sanford* case was followed in *Geisenberger & Friedler et al. v. Robert York & Co. et al.,* 262 F. 739 (C. C. A. 5, 1919) and *In re Federal Coal Co.,* 31 F. (2) 375 (1927).

> cited, in which the action of the directors of a corporation in securing to themselves preferences in the hour of its extremities has been adjudged void, *and that it is going too far to hold that a corporation may not give a mortgage to its directors who have lent their credit to it, to induce a continuance of the loan of that credit, and obtain renewals of maturing paper at a time when the corporation, though not in fact possessed of assets equal to its indebtedness, is a going concern, and is intending and expecting to continue in business.* We are, therefore, of opinion that the Circuit Court erred, * * *." (p. 320, *ibid.*) (Emphasis supplied.)

Under this decision the Van Sweringens would have been entitled, for their own protection, to take a second mortgage on the Vaness and C. T. B. assets pledged with Morgan. Under this decision the Van Sweringens, in guaranteeing the loans to Vaness and C. T. B., unquestionably acted in good faith. Yet the court below found that "bad faith and breach of fiduciary duty were implicit" in the purchase by the Van Sweringens of the collateral securing the guaranteed loans and further held that the Van Sweringens were not entitled, as "endorsers and guarantors of heavy obligations" of their corporations, to protect themselves against liability. (R. 179, 185.)

If the opinion below is allowed to stand, directors will know that in the Sixth Circuit their duty of loyalty is a dangerous duty. They will know that they act at their peril in pledging their personal credit on behalf of their companies—however urgent the need and however wise the pledge from a business standpoint. They will know that although previously courts have encouraged a director's willingness to risk his own resources for the sake of the corporate enterprise,* today this outlook no longer pre-

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* As the Court said in *Arn v. Operators Royalty & Producing Co.*, 13 Fed. Supp. 769, 773 (1936), an officer who has made a loan in good faith "* * * should be commended rather than condemned for the action * * *."

vails. They will know finally that all fiduciaries are lumped indiscriminately into one large class; that the right to protect a legitimate interest (which is the underlying theme of *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *In re New York Railways Corp.,* all *supra*) is no longer extended to corporate directors; and that a rule which in equity and fairness has previously been applied only to profit-seeking volunteers (having no pre-existing interest to protect) is now applied even to directors who, because of their position as guarantors or sureties, seek simply to reduce overwhelming losses and to minimize enormous liabilities.

CONCLUSION.

It is respectfully submitted that this Court should grant Midamerica's petition for a writ of certiorari in order (a) to resolve a conflict of decision between the Circuit Courts of Appeals of the Second and Sixth Circuits on a matter of importance in the administration of the Bankruptcy Act, or, in the alternative, to resolve a conflict between the decision below and the applicable state law, and (b) to remove the doubt, confusion and uncertainty which have been engendered in the law of corporate fiduciaries through overzealous application by the court below of *Pepper v. Litton* and its failure to follow the equitable principles laid down in *Twin-Lick Oil Co. v. Marbury, Sanford Fork & Tool Company v. Howe, Brown & Company,* and *Arn v. Bradshaw Oil & Gas Co.*

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